

Message Text

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ACTION TRSE-00

INFO OCT-01 EA-11 ISO-00 NEA-14 IO-14 AID-20 CIAE-00

COME-00 EB-11 FRB-02 INR-10 NSAE-00 RSC-01 XMB-07

OPIC-12 SP-03 CIEP-02 LAB-06 SIL-01 OMB-01 NSC-07

SS-20 STR-08 CEA-02 L-03 H-03 PA-04 PRS-01 USIA-15

DRC-01 /180 W

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R 070723Z MAY 74

FM AMEMBASSY MANILA

TO SECSTATE WASHDC 3250

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USADB

FOR NAC AGENCIES

E.O. 11652: DELCAS 5-7-75

TAGS: EAID, EFIN

SUBJECT: LENDING FOREIGN EXCHANGE FOR LOCAL CURRENCY
EXPENDITURES ON PROJECTS

SUMMARY: DURING PAST SEVERAL YEARS ASIAN DEVELOPMENT
BANK HAS BEEN URGED BY DEVELOPING MEMBER COUNTRIES
(DMCS) TO UNDERTAKE FINANCING OF LOCAL CURRENCY EXPENDI-
TURES, BUT MAINLY DUE TO RESOURCES CONSTRAINTS BANK HAS
DECLINED TO ENGAGE ITSELF IN THIS TYPE OF FINANCING.
WITH IMPENDING ESTABLISHMENT OF ASIAN DEVELOPMENT FUND
(ADF) AND CONSIDERING RELATIVELY ADEQUATE ORDINARY
CAPITAL POSITION, BANK MANAGEMENT IS NOW RECOMMENDING
FINANCING OF "REASONABLE PORTION" OF LOCAL CURRENCY
EXPENDITURE ON LIMITED AND SELECTIVE BASIS. MANAGEMENT
PROPOSES THAT ELIGIBILITY BE DETERMINED BASED ON BOTH
COUNTRY AND PROJECT CRITERIA, AND THAT LOCAL CURRENCY
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EXPENDITURES FINANCING BE LIMITED TO 5 PERCENT OF BANK'S

ANNUAL LENDING FROM ORDINARY CAPITAL RESOURCES AND 10 PERCENT OF ITS ANNUAL LENDING FROM SPECIAL FUNDS RESOURCES. USADB CONSIDERS BANK PROPOSAL REASONABLE AND RECOMMENDS A FAVORABLE NAC ACTION. END SUMMARY.

1. ADB WORKING PAPER 5-74 ENTITLED "LENDING FOREIGN EXCHANGE FOR LOCAL CURRENCY EXPENDITURES ON PROJECTS" POUCHED APRIL 17 AND WILL BE DISCUSSED BY BOARD ON MAY 30.

2. FOR MANY YEARS, BANK HAS BEEN REQUESTED BY DMCS TO CONSIDER FINANCING OF LOCAL CURRENCY EXPENDITURES BUT BANK HAS CONSISTENTLY MAINTAINED POSITION THAT ITS RESOURCES, ESPECIALLY CONCESSIONAL FUNDS, WERE TOO MEAGER AND BANK WAS TOO NEW TO PROVIDE THIS TYPE OF FINANCING. HOWEVER, MANAGEMENT IS NOW RECONSIDERING ITS POSITION ON LOCAL COST FINANCING BASED ON FOLLOWING FACTORS:

(A) POSITION OF BANK'S RESOURCES HAS IMPROVED AS RESULT OF INCREASE IN CAPITAL STOCK AND ANTICIPATED LAUNCHING OF ASIAN DEVELOPMENT FUND WITHIN NEXT THREE MONTHS.

(B) NEED FOR FINANCING LOCAL EXPENDITURES STILL IMPERATIVE PARTICULARLY IN LESSER DEVELOPED COUNTRIES WHICH ARE UNABLE TO GENERATE SUFFICIENT SAVINGS DUE TO LOW PER CAPITA INCOME.

(C) FINANCING OF ONLY FOREIGN EXCHANGE COSTS SOMETIMES AFFECTS JUDICIOUS SELECTION OF PROJECTS BY ENCOURAGING BIAS TOWARDS CAPITAL-INTENSIVE PROJECTS. LOCAL FINANCING WOULD ENABLE BANK TO PLAY MORE EFFECTIVE ROLE AS DEVELOPMENT INTERMEDIARY BY TAKING ON PROJECTS WITH LARGE SOCIAL IMPACT BUT WITH SMALL FOREIGN EXCHANGE COMPONENT.

(D) ADB IS IN SOMEWHAT UNFAVORABLE POSITION VIS-A-VIS IBRD/IDA WHICH PROVIDES FINANCING OF LOCAL EXPENDITURES, AS DOES IDB.

3. BOTH ARTICLE 13(II) OF ADB CHARTER AND SECTION 3.05 OF ADF REGULATIONS EMPOWER BANK TO FINANCE LOCAL CURRENCY EXPENDITURES.

4. ELIGIBILITY FOR LOCAL EXPENDITURE FINANCING WOULD BE LIMITED OFFICIAL USE

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DETERMINED BASED ON BOTH COUNTRY AND PROJECT CONSIDERATIONS. COUNTRY ELIGIBILITY WOULD BE DETERMINED BY FOLLOWING GUIDELINES:

(A) THAT DMC CONCERNED IS MAKING REASONABLE EFFORT TOWARDS DEVELOPMENT IN GENERAL AND TOWARDS DOMESTIC MOBILIZATION OF RESOURCES FOR DEVELOPMENT IN PARTICULAR;

(B) THAT AVAILABLE RESOURCES ARE BEING ALLOCATED BY DMC CONCERNED IN REASONABLY PRUDENT MANNER TO FINANCE

DEVELOPMENT PROGRAM;

(C) THAT FINANCIAL REQUIREMENTS OF DEVELOPMENT PROGRAM OF DMC CONCERNED WILL EXCEED REASONABLE LIMITS OF DOMESTIC SAVINGS AND EXPECTED AVAILABILITY OF FOREIGN RESOURCES;

(D) THAT THESE REQUIREMENTS CANNOT BE MET ADEQUATELY BY FINANCING ONLY FOREIGN EXCHANGE COSTS OF DEVELOPMENT PROJECTS;

(E) THAT, IN EXCEPTIONAL CASES, LOCAL EXPENDITURE FINANCING BY BANK IS DESIRABLE, IN INTEREST OF JUDICIOUS MIX OF DEVELOPMENT PROJECTS IN DMC CONCERNED, IN A PROJECT OR PROJECTS HAVING HIGH PRIORITY BUT INVOLVING LOW FOREIGN EXCHANGE COSTS;

(F) THAT IT IS JUSTIFIED BY OVERALL BALANCE OF PAYMENTS SITUATION AND TRENDS, INCLUDING CURRENT AND PROSPECTIVE OVERALL FOREIGN EXCHANGE AVAILABILITY AND UTILIZATION IN DMC; AND

(G) THAT CONTEMPLATED LOCAL CURRENCY FINANCING DOES

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FOR NAC AGENCIES

NOT PUT EXCESSIVE STRAIN ON ECONOMY CONCERNED.

4. IF RECIPIENT COUNTRY QUALIFIES FOR LOCAL COST FINANCING ON COUNTRY GROUND, FINAL DETERMINATION FOR ELIGIBILITY WOULD BE MADE ON PROJECT CONSIDERATION.

GENERAL GUIDELINES WOULD BE AS FOLLOWS:

(A) PREFERENCE TO BE GIVEN TO PROJECTS WHICH HAVE RELATIVELY LOW FOREIGN EXCHANGE COMPONENT BUT HAVE RELATIVELY HIGH ECONOMIC AND SOCIAL BENEFITS. THIS WILL INCLUDE PROJECTS SUCH AS LESS CAPITAL-INTENSIVE PROJECTS, E.G., IRRIGATION, FEEDER ROADS, LIVESTOCK, ETC.

(B) PUBLIC UTILITY PROJECTS HAVING SIGNIFICANT SOCIAL IMPACT, SUCH AS WATER SUPPLY AND SEWERAGE WILL HAVE HIGH PRIORITY.

NOTE SPECIFICALLY THAT INDUSTRIAL PROJECTS, INCLUDING CREDIT LINES TO INDUSTRIAL DEVELOPMENT BANKS WILL BE EXCLUDED FROM CONSIDERATION BUT CREDIT LINES TO LIMITED OFFICIAL USE

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AGRICULTURAL BANKS OR AGRICULTURAL CREDIT INSTITUTIONS WILL BE ELIGIBLE FOR LOCAL COST FINANCING.

6. TAKING VARIOUS PERTINENT FACTORS INTO ACCOUNT, ADB MANAGEMENT RECOMMENDS THAT BANK'S LOCAL COST FINANCING INITIALLY BE LIMITED TO 5 PERCENT OF ITS ANNUAL LENDING FROM ORDINARY CAPITAL RESOURCES AND 10 PERCENT OF ITS ANNUAL LENDING FROM SPECIAL FUNDS RESOURCES. BANK INDICATES THAT IT WILL BE CAUTIOUS AND SELECTIVE IN FINANCING LOCAL EXPENDITURES UNTIL EXPERTISE IS BUILT UP IN THIS AREA. FURTHERMORE, BANK INTENDS PARTICULARLY TO EMPHASIZE SELF-HELP EFFORT TO MOBILIZE DOMESTIC RESOURCES BY FINANCING "REASONABLE PORTION" OF LOCAL EXPENDITURES.

7. LOCAL COST FINANCING BY BANK HAS BEEN ADVOCATED BY MANY DMC GOVERNORS AND DIRECTORS IN THEIR RESPECTIVE ANNUAL MEETING SPEECHES AND BOARD COMMENTS. INABILITY TO FINANCE LOCAL COSTS DOES PLACE ADB IN UNFAVORABLE AND NON-COMPETITIVE POSITION IN SOME CASES, AS IBRD/IDA HAVE ACTIVELY PROVIDED THIS TYPE OF FINANCING FOR MANY YEARS IN SOME COUNTRIES RECEIVING ADB ASSISTANCE. INITIAL LOCAL COST FINANCING LIMITS OF 5 PERCENT ON ORDINARY CAPITAL AND 10 PERCENT ON SPECIAL FUNDS OPERATIONS (OR MAXIMUM OF \$35 MILLION BASED ON PROJECTED 1974 LOAN COMMITMENTS OF \$500 MILLION), WOULD COMPARE WITH IBRD/IDA FIGURES COVERING LAST FOUR YEARS OF 3.0 AND 8.1 PERCENT RESPECTIVELY. IN GENERAL, USADB SUPPORTS BANK PROPOSAL AND RECOMMENDS FAVORABLE NAC ACTION. USADB WOULD PREFER TO SEE MORE PRECISE DEFINITION OF "REASONABLE PORTION" OF

TOTAL LOCAL CURRENCY EXPENDITURES ON PROJECTS AND
INTENDS TO PURSUE THIS MATTER WITH MANAGEMENT.
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